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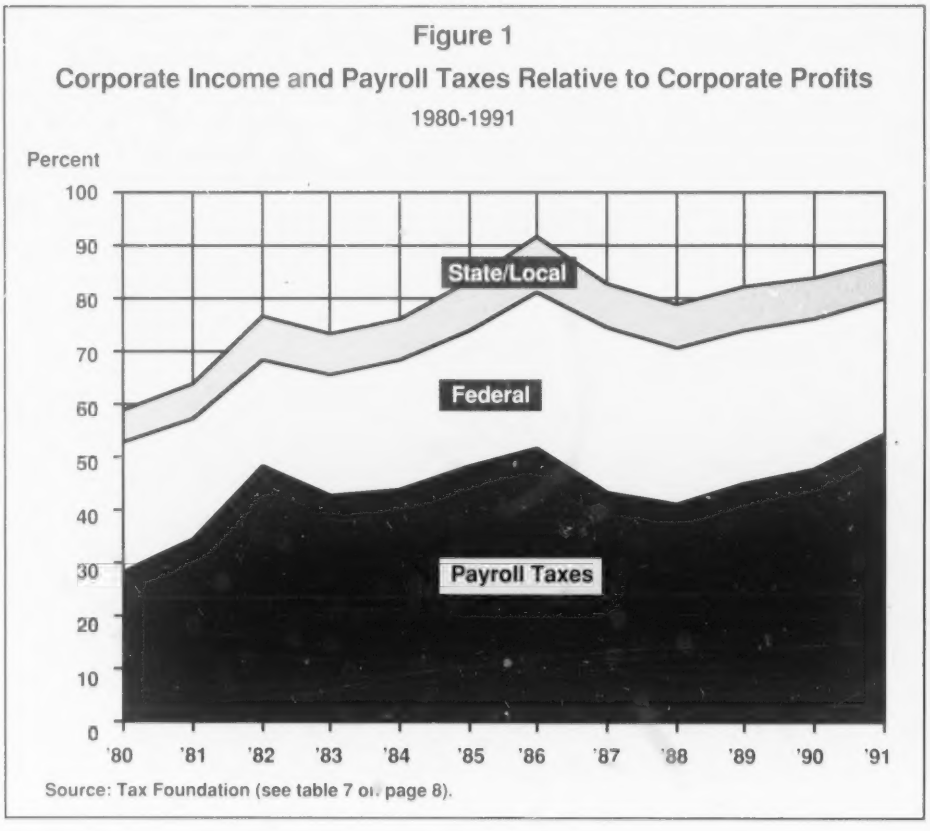
Corporate Tax Burden Rises As Profits Fall

by Paul G. Merski

As the federal deficit approaches a record level of over $300 billion and pressures build for increased spending on new and existing programs, the government will continue its drive for more revenues. Corporations are often targeted and charged with evading their "fair share" of the nation's tax burden. Stale as the theme of undertaxed corporations is, its repetition has given it a life of its own despite convincing evidence to the contrary. In fact, corporations carry a heavy tax burden and provide a large and growing percentage of the total tax revenues

Figure 1: State and local corporate income taxes have been increasing rapidly, and corporate payroll taxes are now the largest part of the business tax burden. Over the past decade, the combination of these increases with federal income taxes have caused a sharp rise in the overall corporate tax burden.



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collected by all levels of government.

The object of this report is to present the current level of the corporate tax burden and examine why and how it has changed since 1980. A consistent time frame of 1980 to 1991 is used throughout the study.

Recent Tax History

The past decade saw a record number of major federal tax legislative changes affecting both individuals and corporations. The result of this "productivity" on the part of taxwriters was a net reduction in individual income tax revenues and a net increase in the corporate income tax take. Table 1 shows the recent impact of the decade's tax legislative changes on individual and corporate income tax receipts. In 1991 alone, for example, individual income tax receipts will be $291 billion lower than they would have been had the tax code

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Table 1

Impact of Major Tax Legislation, Enacted 1980-1990[a], on Individual and Corporate Income Tax Receipts

Fiscal Years 1988-1992

($Billions)

Income Tax	1988	1989	1990	1991(e)	1992(e)
Individual	$-201.4	$-243.9	$-266.9	$-291.0	$-323.8
Corporate	+24.2	+27.3	+35.0	+47.5	+49.8

[a] Budget effect revenue estimates are prepared by the Office of Management and Budget. They measure only the direct effect of tax legislative changes on receipts with feedback effect limited to the overall income forecast and its impact on receipts by major source.

Source: Budget of the U.S. Government, FY'90, '91, and '92, and Tax Foundation.

Table 2

Net Effect of Major Legislation on Corporate Income Tax Receipts

($Billions)

Year	1981 ERTA	1982 TEFRA	1984 DEFRA	1986 TRA	1987 Act	1988 Act[a]	1989 OBRA[b]	1990 OBRA	Other[c]	Total
1982	$ -9.3									$ -9.3
1983	-16.0	$ 5.7								-10.3
1984	-23.7	14.6	$ 0.5						$ -0.1	-8.7
1985	-34.2	16.2	3.3						-0.4	-15.1
1986	-47.1	28.1	5.9						-0.4	-13.5
1987	-54.2	36.3	8.1	$ 29.1					0.4	19.7
1988	-53.8	36.8	9.8	24.9	$ 4.0				2.5	24.2
1989	-50.1	34.7	10.8	22.4	6.0	$ 0.5			3.0	27.3
1990	-47.6	34.7	11.1	24.4	7.3	0.1	$ 1.8		3.2	35.0
1991	-45.5	36.6	11.8	26.4	8.2	0.3	2.4	$ 3.8	3.5	47.5
Total	-381.5	243.7	61.3	127.2	25.5	0.9	4.2	3.8	11.7	96.8

[a] Includes Family Support Act of 1988, and Technical and Miscellaneous Revenue Act of 1988.

[b] Includes Financial Institutions Reform, Recovery and Enforcement Act, Treasury, Postal Services and General Accounting Acts of 1990, and Medicare Catastrophic Coverage Repeal Act in addition to OBRA.

[c] Includes Highway Revenue Act of 1982, Interest and Dividends Tax Compliance Act of 1983, Consolidated OBRA of 1986, Superfund Amendments and Reauthorization Act of 1986, and Continuing Resolutions for 1987 and 1988.

Source: Department of Treasury, Office of Tax Analysis; President's FY'92, '91, '90 Budgets and Tax Foundation.

remained unchanged throughout the decade. Corporate income taxes, on the other hand, will be $48 billion higher in 1991 due to the net impact of major tax legislation since 1980.

The past decade saw a record number of major federal tax legislative changes affecting both individuals and corporations. The result of this "productivity" on the part of taxwriters was a net reduction in individual income tax revenues and a net increase in the corporate income tax take.

The decade began on a favorable note for corporate America when Congress enacted the Economic Recovery Tax Act of 1981 (ERTA). If this sizeable tax cut had been allowed to take effect fully over the next several years, it would have substantially reduced overall corporate income tax liabilities.

Instead, right on the heels of ERTA came the Tax Equity and Fiscal Responsibility Act (TEFRA) in 1982, the largest tax increase of the decade. Combined with the Deficit Reduction Act (DEFRA) in 1984, 80 percent of the corporate tax cuts granted under ERTA were eliminated. The Tax Reform Act of 1986 more than made up for any remaining tax reduction from ERTA by extracting an additional $127 billion in corporate tax revenues over a five-year period.

In 1991 alone . . . individual income tax receipts will be $291 billion lower than they would have been had the tax code remained unchanged throughout the decade. Corporate income taxes, on the other hand, will be $48 billion higher in 1991 due to the net impact of major tax legislation since 1980.

More recently, further increases in corporate income taxes have been included in the Omnibus Budget Reconciliation Act of 1987, the Continuing Resolution for 1988, and the Omnibus Reconciliation Acts of 1989 and 1990. Table 2 details the net effect of major tax legislation on corporate income tax receipts since 1980. Despite the initial corporate tax cuts under ERTA in 1981, corporations had by 1987 witnessed $20 billion or more in additional tax liability each year due to major tax legislative changes.

It should be noted that tax increases conceived in the midst of a budget crisis, in the fiscal year's final days or even after the fiscal year has ended, are rarely carefully considered decisions based on sound principles of fiscal policy. Such last-minute revenue-raisers have hit individuals and corporations, but more often, due to the political context of the revenue-raising process, corporations are the easier tax target.

On only two pieces of legislation during the eighties was tax policy's effect on the economy the primary concern of federal taxwriters: ERTA in 1981 and the Tax Reform Act of 1986. Otherwise,

Table 3

Federal Corporate Income Tax Receipts

Selected Fiscal Years 1980-1992

Year	Federal Corporate Income Tax Receipts ($Billions)	% of Total Federal Income Tax Receipts
1980	$64.6	20.9%
1981	61.1	17.6
1982	49.2	14.2
1983	37.0	11.4
1984	56.9	16.0
1985	61.3	15.5
1986	63.1	15.3
1987	83.9	17.6
1988	94.5	19.1
1989	103.3	18.8
1990	93.5	16.7
1991[a]	95.9	16.3
1992[a]	101.9	16.1

[a] Estimate.
Source: Office of Management and Budget, President's FY'92 Budget.

the major drive behind all of the decade's tax legislation was purely and simply to increase tax revenues.

Corporate Share of the Tax Burden

Over the past decade corporate income taxes have shrunk as a share of total income taxes, in large measure due to the volatility of corporate profits. As table 3 indicates, corporate income tax receipts dropped off sharply in 1982 and 1983, both absolutely and as a percentage of total income taxes. The severe recession of 1981-1982 had its maximum impact on tax revenues in fiscal 1982 and 1983, and this was also the period when the Accelerated Cost Recovery System (ACRS) first took hold. This more rapid depreciation initially depressed tax collections but would be made up in later years.

Starting in 1984, corporate income tax collections increased sharply, leaping from a low of $37 billion in 1983 to a record $103 billion in 1989. The growth in corporate tax revenue during this period was the result of strong economic growth and, of course, the implementation of the 1982, 1984, and 1986 tax bills which increased the corporate tax burden. The economic slowdown and current recession have caused a decline in corporate profits resulting in lower than expected corporate tax revenues. Corporate income tax receipts, which made up 20.9 percent of total federal income tax receipts in 1980, are estimated to yield 16.3 percent in 1991.

On only two pieces of legislation during the eighties was tax policy's effect on the economy the primary concern of federal taxwriters: ERTA in 1981 and the Tax Reform Act of 1986. Otherwise, the major drive behind all of the decade's tax legislation was purely and simply to increase tax revenues.

Corporate Income Taxes and GNP

Table 4 presents federal corporate income taxes as a percent of Gross National Product (GNP) and of total federal receipts. Corporate federal income taxes have declined from 2.4 percent of GNP in 1980 to an estimated 1.7 percent in 1991. As one would expect, corporate taxes as a percentage of total federal revenues follow a similar trend. In 1980, corporate income taxes comprised 12.5 percent of federal tax receipts and now represent 8.8 percent (see figure 2).

Table 4

Federal Corporate Income Taxes as a Percent of GNP and Total Federal Receipts

Fiscal Years 1980-1991

($Billions)

Fiscal Year	Corporate Income Tax	GNP	Total Federal Receipts	Corporate Income Tax As a % of GNP	Corporate Income Tax As a % of Total Fed. Receipts
1980	$64.6	$2,670.6	$517.1	2.4%	12.5%
1981	61.1	2,986.4	599.3	2.0	10.2
1982	49.2	3,139.1	617.8	1.6	8.0
1983	37.0	3,321.9	600.6	1.1	6.2
1984	56.9	3,687.7	666.5	1.5	8.5
1985	61.3	3,952.4	734.1	1.6	8.4
1986	63.1	4,180.8	769.1	1.5	8.2
1987	83.9	4,424.7	854.1	1.9	9.8
1988	94.5	4,780.4	909.0	2.0	10.4
1989	103.3	5,131.3	990.7	2.0	10.4
1990	93.5	5,405.6	1,031.3	1.7	9.1
1991[a]	95.9	5,615.8	1,091.4	1.7	8.8

[a] Estimate.

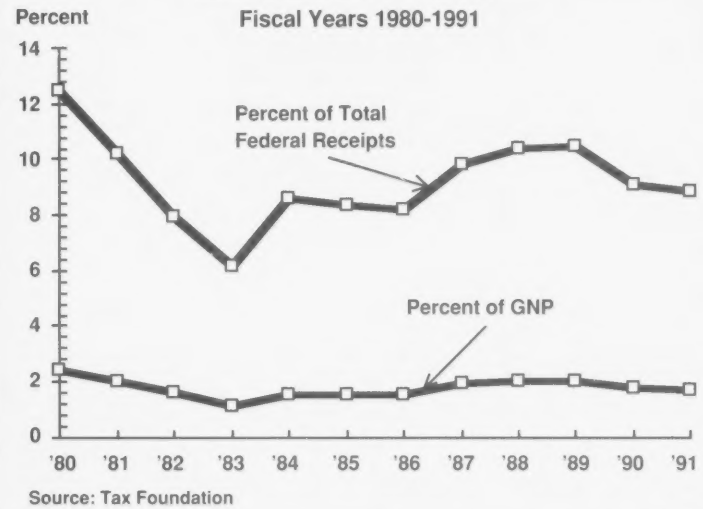
Source: Office of Management and Budget; President's FY'92 Budget and Tax Foundation computations.

Why Corporate Income Taxes Have Declined Relative to GNP

Several important factors have changed the relationship between corporate income taxes and GNP. Four primary factors are: corporate profitability, corporate financing, effective tax rates, and the level of other taxes paid by corporations.

Figure 2

Federal Corporate Income Taxes as a Percent of GNP and Total Federal Receipts



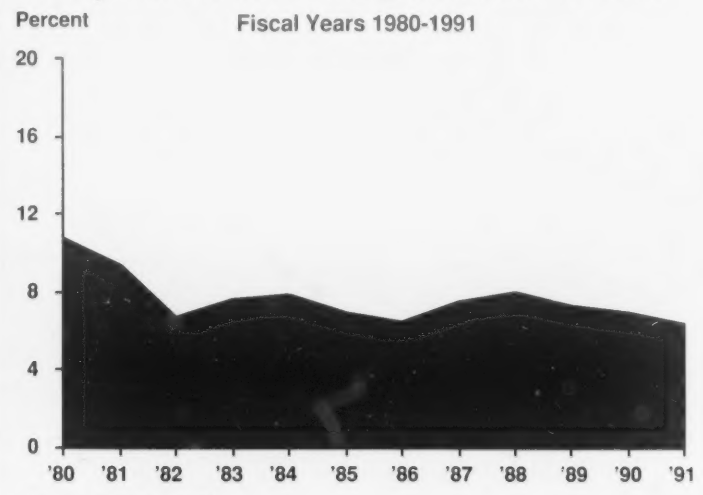
Source: Tax Foundation

Corporate Profits

Critical factors involved in accurately examining the trend in corporate income taxes are both the level of corporate profits and their share of national income. A major cause of the decline of corporate income taxes as a percentage of GNP in recent years was the decline in corporate profitability. Table 5 shows that the trend in corporate profits as a percentage of national income has been irregularly downward. In fact, this downturn has closely paralleled that of corporate tax receipts as a percent of total income taxes. In 1980, corporate profits made up 10.8 percent of national income, but by 1990 they accounted for a mere 6.3 percent (see figure 3). The decline in corporate profits alone explains much of the recent

Figure 3

Corporate Profits as a Percent of National Income



Source: Tax Foundation

Table 5

Total Before-Tax Corporate Profits

1980-1991

Year	Total Before-Tax Corporate Profits ($Billions)	Percent of National Income
1980	$237.1	10.8%
1981	226.5	9.3
1982	169.6	6.7
1983	207.6	7.6
1984	240.0	7.9
1985	224.3	6.9
1986	221.6	6.5
1987	275.3	7.5
1988	316.7	7.9
1989	307.7	7.3
1990	304.7	6.9
1991[a]	282.7	6.3

[a] 1991, QI annual rate.

Source: Department of Commerce, Bureau of Economic Analysis; and Tax Foundation computations.

decline in the proportion of corporate income taxes represented in the total tax revenue picture.

Corporate Financing

The growth in corporate debt is another cause of the decline in corporate taxes as a percentage of GNP. Corporations finance their activities through a combination of equity owners' investment and debt. In recent years, debt-financed acquisitions, leveraged buyouts, and debt for stock exchanges have replaced a substantial amount of corporate stock with debt. The increased interest expense on corporate debt offsets corporate income and tax liability, reducing the tax take.

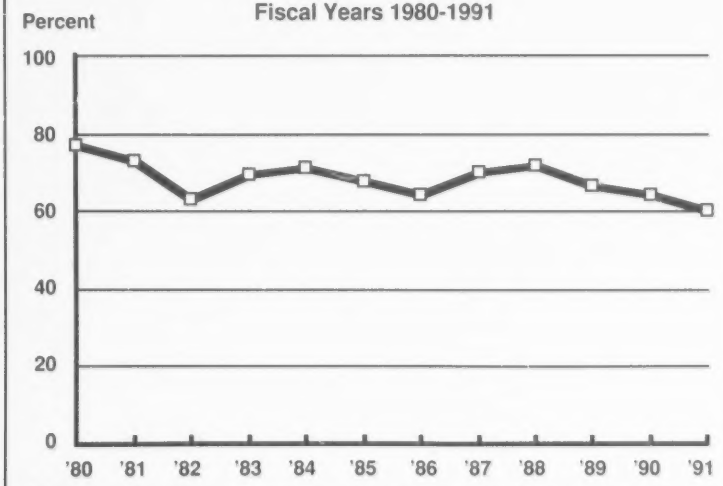
The relationship between corporate profits and total corporate return — profits plus interest — indicates the extent to which corporations are debt-financed as well as the cost of corporate debt. If a corporation has very little debt and, consequently, pays very little interest, the percentage is close to 100. It will decline as the cost of debt increases, either because the corporation is heavily leveraged or because interest rates rise. The relationship between profits and total return for 1980 through 1991 is shown in figure 4. This percentage dropped from 77 percent in 1980 to 60 percent by 1991, indicating the growth in debt financing and interest costs.

In 1980, corporate profits made up 10.8 percent of national income, but by 1990 they accounted for a mere 6.3 percent. The decline in corporate profits alone explains much of the recent decline in the proportion of corporate income taxes represented in the total tax revenue picture.

Figure 4

Relationship Between Profits and Total Return to Corporate Activity[a]

Fiscal Years 1980-1991



[a] Profits would be 100 percent of the return to corporate activity if there were no debt financing.

Source: Tax Foundation and Department of Commerce, Bureau of Economic Analysis.

Effective Tax Rates

Corporations are taxed at a higher effective rate than individuals, and for 1991, the disparity is 15.4 percent, with the average effective tax rate for individuals at 10.4 percent while the corporate rate reached 25.8 percent (see table 6). The individual effective rate has fallen from 11.1 percent in 1980 to 10.4 percent in 1991. The corporate effective rate for the decade peaked at 31 percent in 1987 and has since declined to 25.8 percent in 1991 (see figure 5). Taxes as a percentage of GNP will go down when effective rates (the ratio of taxes to before-tax corporate profits) decrease.

Other Taxes On Corporations

Of course, federal corporate income taxes are only part of the corporate tax picture, and they cannot be examined in isolation. State and local corporate income taxes and corporate payroll taxes have been increasing rapidly, and the overall burden of federal corporate income taxes when combined with these taxes is illustrated in table 7 and figure 1.

While federal corporate income tax revenues have risen 24 percent since 1980, state/local corporate income tax revenues have increased 39 percent for the decade and are now 28 percent as large as the federal tax levy. The combined federal and state/local corporate income effective tax rate in 1991 is 32.9 percent, up from 30.8 percent in 1980.

While state/local income taxes have grown sharply over the past decade, the largest element of the business tax burden has become the payroll sector, particularly federal social security and hospital insurance. Furthermore, state unemployment insurance and other social insurance funds have intensified the corporate tax burden. The corporate share of payroll taxes has outstripped corporate income taxes and currently amounts to $153 billion.

Over the past decade, the combined increases in federal income taxes and the state/local and payroll taxes have caused a tremendous increase in the overall corporate tax burden. Compared to corporate profits, this burden increased 28.1 percentage points from 58.9 in 1980 to 87 percent by 1991. Throughout the 1970s, this rate averaged only 60 percent.

The 1991 overall corporate tax burden, representing a whopping 87 percent of corporate profits, is huge by historic comparison. The decline in corporate profitability combined with the sharp growth trend in state and payroll taxes could easily push this burden even higher.

Table 6

Comparison of Personal and Corporate Effective Income Tax Rates

Federal Income Taxes 1980-1991

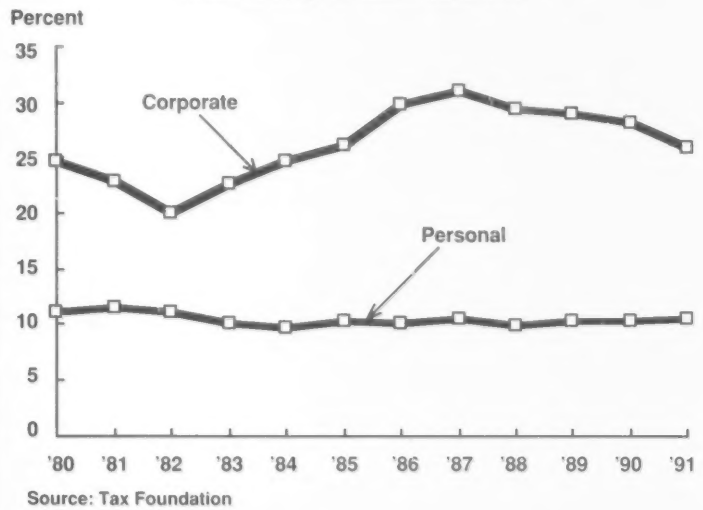
	Personal			Corporate		
Year	Income Taxes	Total Income	Effective Tax Rate	Income Taxes	Profits	Effective Tax Rate
1980	$ 251.1	$ 2,258.5	11.1%	$ 58.6	$ 237.1	24.7%
1981	291.7	2,520.9	11.6	51.7	226.5	22.8
1982	296.5	2,670.8	11.1	33.8	169.6	19.9
1983	288.1	2,838.6	10.1	47.1	207.6	22.7
1984	303.7	3,108.7	9.8	59.2	240.0	24.7
1985	339.4	3,325.3	10.2	58.5	224.3	26.1
1986	353.5	3,526.2	10.0	66.0	221.6	29.8
1987	397.2	3,766.4	10.5	85.4	275.3	31.0
1988	405.7	4,070.8	10.0	93.2	316.7	29.4
1989	453.1	4,384.3	10.3	88.8	307.7	28.9
1990	479.1	4,645.5	10.3	86.0	304.7	28.2
1991[a]	492.7	4,737.0	10.4	72.8	282.7	25.8

[a] 1991, QI annual rate.
Source: Department of Commerce, Bureau of Economic Analysis, and Tax Foundation.

Figure 5

Comparison of Personal and Corporate Effective Income Tax Rates

Federal Income Taxes 1980-1991



Source: Tax Foundation

Summary

Despite the overall decline in corporate profits over the past several years, the combined impact of federal, state/local, and payroll taxes has increased the corporate tax burden. The net effect of a decade of federal tax legislation, even starting with ERTA in 1981, will total $96.8 billion in additional corporate tax revenues for the ten-year period. The overall corporate tax burden relative to corporate profits has increased from 58.9 percent in 1980 to 87 percent by 1991. In recent years, lower corporate profits, increased corporate debt, sharp growth in state/local taxes as well as payroll taxes resulted in lower than estimated corporate tax revenues.

Table 7

Federal and State/Local Corporate Income Taxes and Corporate Payroll Taxes

National Income Account Series

1980-1991

($Billions)

Year	Before Tax Corporate Profits	Federal Corporate Income Tax Accruals[a]	Effective Rate of Federal Tax	State/Local Corporate Income Tax Accruals	Effective Rate of Federal and State/Local Tax	Corporate Payroll Taxes[b]	Income and Payroll Taxes Relative to Corporate Profits
1980	$ 237.1	$ 58.6	24.7%	$ 14.5	30.8%	$ 66.6	58.9%
1981	226.5	51.7	22.8	15.4	29.6	77.6	63.9
1982	169.6	33.8	19.9	14.0	26.2	81.7	76.4
1983	207.6	47.1	22.7	15.9	30.3	89.0	73.2
1984	240.0	59.2	24.7	18.7	32.5	104.4	76.0
1985	224.3	58.5	26.1	20.2	35.1	107.6	83.1
1986	221.6	66.0	29.8	22.5	39.9	114.2	91.5
1987	275.3	85.4	31.0	23.7	39.6	119.4	83.0
1988	316.7	93.2	29.4	25.7	37.5	130.6	78.8
1989	307.7	88.8	28.9	24.7	36.9	138.7	82.0
1990	304.7	86.0	28.2	23.6	36.0	145.8	83.8
1991[c]	282.7	72.8	25.8	20.1	32.9	153.0	87.0

[a] Net of Federal Reserve Earnings

[b] Includes corporate employer share of OASDHI, state unemployment insurance tax, federal unemployment tax, railroad unemployment insurance and retirement, and workers' compensation.

[c] 1991, QI annual rate

Sources: Published and unpublished statistics of the Department of Commerce, Bureau of Economic Analysis, and Tax Foundation computations.

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